Faculty of Economics and Business

RISK DISCLOSURE AND FIRM PERFORMANCE OF MALAYSIA LISTED COMPANIES

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Statement of Originality

The work described in this Final Year Project, entitled
"RISK DISCLOSURE AND FIRM PERFORMANCE OF MALAYSIA LISTED COMPANIES"
is to the best of the author's knowledge that of the author except where due reference is made.

16/12/15

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Abstract

Risk Disclosure and Firm Performance of Malaysia Listed Companies

By

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This empirical study is conducted to examine whether the level of risk discloses practice in Malaysia and its determinants had contributed to financial firm performance from year 2010- 2014. A total of 565 firms selected from Bursa Malaysia listed companies. The indicators of firm performance, such as Tobin's Q and Return on Assets (ROA) acts as dependent variables. Whereas the corporate risk disclosure index (CRD), growth, leverage and firm size as independent variables. The results show leverage and corporate risk disclose (CRD) are positive and significant associated with firm performance (Tobin's Q) from the financial perspective. However, there is no evidence of a significant relationship between growth and firm size with the firm performance. On the other hand, the determinants of leverage and firm size presence a positive and significant relationship with firm performance (ROA) from accounting perspective. The corporate risk discloses (CRD) and growth show insignificant association with firm performance from an accounting perspective.

Abstrak

Pendedahan Risiko dan Prestasi Firma terhadap Syarikat Malaysia yang Tersenarai di Bursa Malaysia

Oleh

Chan Hui Lun

Kertas kerja ini megkaji sama ada tahap pendedahan risiko dan penentunya menyumbang kepada prestasi kewangan firma dari tahun 2010 sehingga 2014. Kajian dijalankan dengan menggunakan sebanyak 565 buah syarikat tersenarai di Bursa Malaysia. Petunjuk prestasi firma, seperti Tobin Q dan Pulangan atas Aset (ROA) bertindak sebagai pembolehubah yang bersandar. Manakala indeks pelaporan risiko korporat (CRD), pertumbuhan, leverage dan saiz firma sebagai pembolehubah bebas tidak bersandar. Daripada perspektif kewanagan, keputusan menunjukkan bahawa leverage dan pendedahan risiko korporat mendedahkan (CRD) mempunyai hubungan yang positif dan signifikan mempengaruhi prestasi firma (Tobin Q). Walau bagaimanapun, tiada bukti hubungan yang signifikan di antara pertumbuhan dan saiz firma dengan prestasi firma. Sebaliknya, dari perspektif perakaunan, penentu leverage dan saiz firma mempunyai hubungan positif dan signifikan dengan prestasi firma (ROA). Di samping itu, pendedahan risiko firma (CRD) dan pertumbuhan tidak menunjukkan hubungan yang signifikan dengan prestasi firma.

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CHAPTER ONE

Introduction

1.0 Introduction

In this new era of globalization, business world evaluates from a borderless arena to compete. By advanced and high speed in communication technology, corporate fall into vulnerable position of risks. One of the ways corporate communicates with various investors are through the annual report. The company's annual report included useful information for the investment making decision. After the infamous Enron and WorldCom scandal happened, the annual report users' need more information disclose, especially the non-financial section (Azlan, Abdul and Bin, 2008).

This study begins with the definition of 'risk' and 'risk disclosures' as it is the scope of this research. **Risk** in finance, in a general sense, can be defined as the expected return rate being higher compared to the actual return rate on investment (Risk, 2015). Besides, Beretta and Bozzolan (2004) defined the **disclosure of risk** as the risk information relates to the firm business plan and other potential external factors that are able to influence the expected results. In other words, firm risk disclosure is about the act of spreading all corresponding company information that may affect the investor's investment decision. In order to make a fair investment for everyone, the company has to disclose good and bad information. Risk disclosure has received considerable interest and attention in recent times. The issue of corporate risk reporting creates more awareness and tension to firm in managing business not in a privately responsible way (Mazurina and Dennis, 2014).

Firm performance defined as the measuring of the achievement of the corporate monetary operation and organization policies. The finding of measurements indicates about the firm return rate in investment, assets return rate, value added and others (Financial performance, 2015). Management of the firm can be improved through a better understanding of firm business risk by stakeholders and others corporate reporting users and hence help the companies allocate the resources efficiently. Thus, the demand for better reporting on business risk has increased.

Risk disclosure in annual reporting can enhance the information transparency, and help the annual report users to make suitable judgement about the firm performance (Linsley and Shrives, 2005). Furthermore, the companies with good risk disclosure can improve the investor reliability and the better understanding of the corporate risk profile. All in all, according to Gordon, Loeb and Tseng (2009) mentioned that good financial reporting can improve the firm risk of disclose, and hence increase the firm performance.

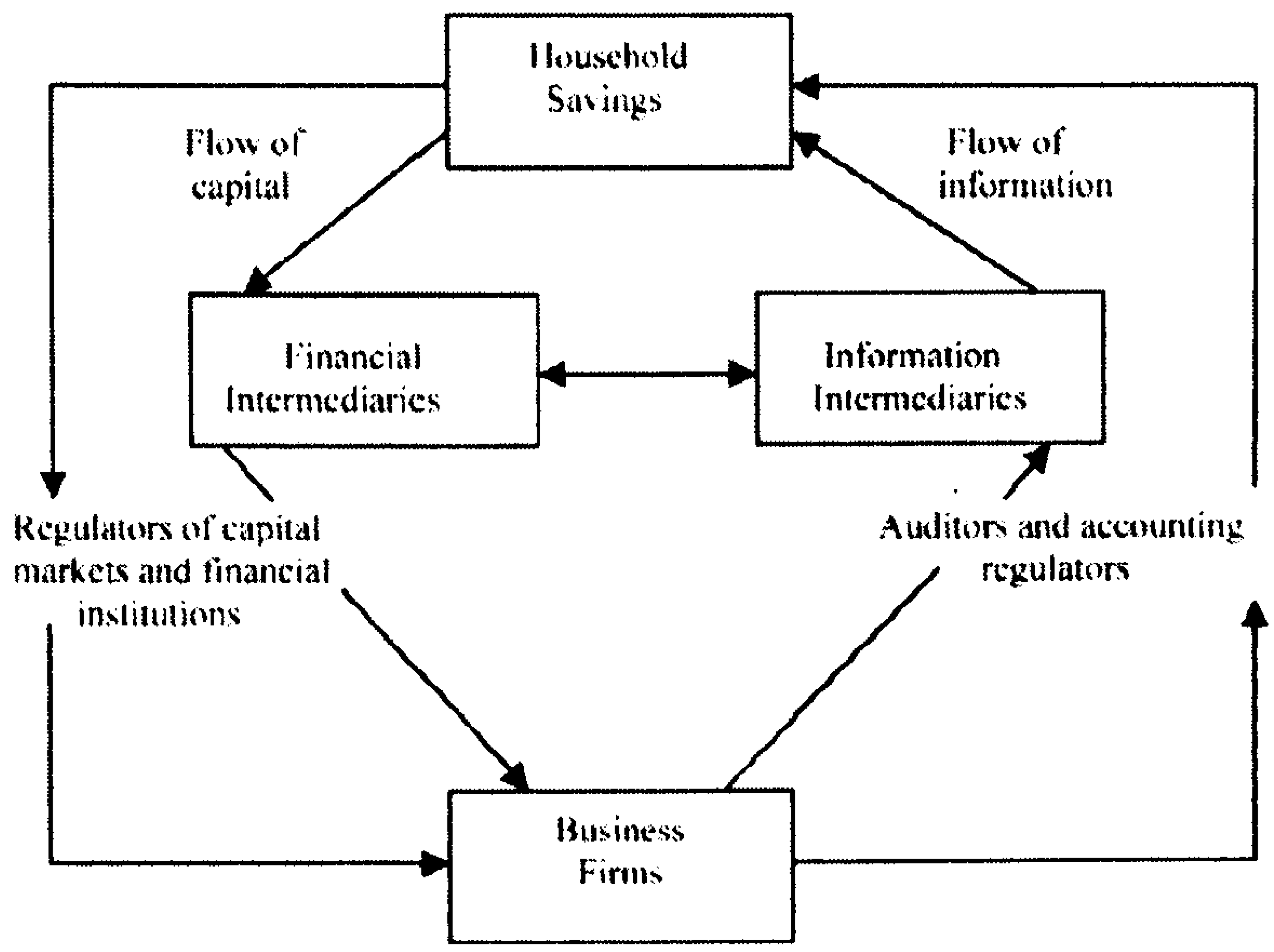
This research aims to determine the influence of risk disclose to the performance of firm in Malaysia listed companies. To conduct this study is mainly due to corporate collapsed during the financial crisis in the year 1997 and the situation becomes more serious when the global subprime crisis occurred at year 2007 (Rosnadzirah and Rashidah, 2013). Some of the factors that cause the organization to collapse mostly lack of corporate governance and weak risk management. Moreover, this research focuses on the empirical test of various risk disclosure determinants on firm performance, which is a growth rate, leverage and firm size. Through the research, the understanding between the risk disclosure and firm performance can be improved.

The organization of this research showed as follows. Firstly, the first part is about the background of study which includes the summarization of the news and articles. Then, it's followed by problem statement, research questions and objectives, contribution of the study. The final part is about the organization of study, which explains the flow of this research.

1.1 Background of Study

The main communication tools between the firm and stakeholders mostly through reporting and disclosure. A firm financial report containing the footnotes, financial statement, management analysis and discussion, and others are a platform for the firm supply the disclosure (Healy and Palepu, 1993). The communication flow of information no matter directly or indirectly between the firm and investors are show as below. The direct information is through the financial intermediaries (annual report) but the indirect information is transferred through the information intermediaries (banks).

Figure 1.1: Financial and information flow in a capitalist market economy



Source: Hearly and Palepu (1993)

Since the year 1997 to 2002, the ICAEW has done precursory work against the quality of risk reporting to be significantly enhanced. Since then, the risk reporting has been improved in a considerable expansion. However, there are 5 core factors that cause the acceptance of firm risk reporting in different sectors to be in suspicions (ICAEW, 2011). First, it is hard to differentiate the accuracy of risk reporting. This can decrease the user's confidence to risk reporting. Second, another reason are the costs for managers. The costs for manager mostly far more than the perceived benefits received from the risk reporting, and hence lead to information asymmetry. The risk reporting itself contains risk and so preparers need to assure the risk reporting and interpreted by the reporting users. Thirdly, the firm might disclose the common risk disclosure in order to obey the demand for the provision of risk lists. Furthermore, the capabilities of managers are important to influence the performance of a corporate risk management, and statement that disclose the company approach to risk and the firm internal structure are not necessarily to explore. Lastly, the firm would not report all risk. According to the ICAEW (2011), there are seven principles for referring to enhance the risk reporting. The seven principles for better risk reporting are stated as below:

- Inform the users about the information that they necessary to know.
- Concentrate on the quantitative risk information.
- Combine the risk information with others risk disclosure.
- Maintain the principal risks lists concise
- Focus on the current issues and concern.
- Review risk experience.

The important to create transparency of risk information in the firm annual report is necessary for beneficial the organization's risk management. The annual report is a way for the firm to communicate with the stakeholders and to provide the information about the organization, for example, the risk report of firm to make better informed decisions. On the other hand, another reason for the firm discloses the transparency of risk in risk reporting is due to the financial crisis, which credit crisis. The world faced the financial crisis in 2007 and even worst in 2008. In addition, the financial services sectors transform significantly due to the crumble of financial markets and the government intervention (Meijer, 2011). Disclosure can enhance the firm allocate resource efficiency and reduce the problem arise from asymmetry of information between the organization and shareholders. The firm can provide disclosure in two ways, mandatory and voluntary disclosure (Adina and Ion, n.d.). Mandatory disclosure is about the information disclosure in order to achieve the demand in law and regulation, however, voluntary disclosure is about the choice of the firm management to disclose useful information to the related annual report users which might influence the user decision making (Nermeen, 2014). The differences between mandatory and voluntary disclosure showed as below.

Table 1.1 : Differences between Mandatory and Voluntary Disclosure

Mandatory Disclosure	Voluntary Disclosure
To fulfil the requirement of disclosure in law and regulation and stock exchange listed rule.	Information disclosure other than Mandatory disclosure.
Publicly disclose.	Free to choose.
Aims fulfil the users' information requirement, and make sure the production quality control passes through the regulation standard.	Aimed to illustrate why corporate seldom disclose private information completely in the market.
Influenced by the presence of regulatory, stock exchange authority, capital market and accounting standard authority.	Affected by the elements that are particular to each organization, for example, culture, behavioral and economic factors.
Determinants: company value, age, and leverage	Determinants: Tobin's Q, Growth Opportunity, Corporate Governance, Size, Profitability, Leverage, and Industry.

Source: Adina and Ion (n.d)

This research will focus more on voluntary disclosure because it is not complying under law and regulation, firm, frequently disclose information voluntarily in order to gain investors' confidence although without the presence of law. (Adina and Ion, n.d.). The figure below shows the previous studies on corporate voluntary disclosure in several countries, for example, Mexico, Japan, France, Hong Kong and others.

Table 1.2: Prior studies on corporate voluntary disclosure in several countries

No.	Author(s)	Country	Reporting Year	Sample	Adjusted R Square %
1	Chau & Gary (2002)	Hong Kong and Singapore	1997	60 listed industry companies in Hong Kong, 62 in Singapore	Hk: 42.7; SG: 72.5
2	Chow & Wong (1987)	Mexico	1982	52 manufacturing companies	16
3	Cooke (1991)	Japan	1988	48 companies	64.6
4	Cooke (1989)	Sweden	1985	90 nonfinancial listed companies	65.8
5	Depoers (2000)	France	1995	102 nonfinancial listed companies	53.8
6	Eng & Mak (2003)	Singapore	1995	158 listed companies	20.6
7	Ferguson et. al (2000)	Hong Kong	1995/1996	142 nonfinancial listed companies	34.2
8	Haniffa & Coke (2001)	Malaysia	1995	139 nonfinancial listed companies	47.9
9	Ho & Wong (2001)	Hong Kong	1997	98 listed companies	31.4
10	Hossain et. Al (1994)	Malaysia	1991	67 nonfinancial listed companies	28.6
11	Hossain et. Al (1995)	New Zealand	1991	55 nonfinancial listed companies	68.2
12	Rulloumier (1995)	Switzerlan d	1991	161 nonfinancial listed companies	42

Source: Nazri A. (2008)

The Financial Accounting Standard Board divided voluntary disclosure into 6 types, which are forward looking information, corporate social responsibilities (CSR) information, firm future plan information, board of director and management information, and information about financial capital market (Ho, and Taylor, 2013). Besides, the risk factors disclosure also under voluntary disclosure. Among the elements above, Malaysia corporate disclosure more of the corporate plan information and pay less attention to the financial capital data, corporate social responsibility information disclosure and forward looking information (Ho and Taylor, 2013).

Based on the prior studies reported, the voluntary disclosure in Malaysia listed firm in the earlier are relatively low, during the year 1994; the mean score for voluntary disclosure with the values only 0.158 indexes (Hossain, Tan, and Adam, 1994). According to Haniffa and Cooke (2002), the mean score for the voluntary disclosure indexes is 0.313. From year 2006 until 2008, the overall mean indexes for voluntary disclosure is around 0.4983. Moreover, the mean indexes for risk disclosure from year 2006 until 2008 reported around 0.5271, 0.5282, and 0.5385 (Rosnadzirah and Rashidah, 2013). This indicated that Malaysia firm started to focus more on the risk disclosure in this recent trend. The corporation found that the efficiency in managing risk became relatively important. However, not all risk factors is necessary to be revealed under the annual report.

This research would focus on examining risk disclosure and firm performance in Malaysia listed companies. Corporate might not have same risk disclosure due to the particular risk factors to each firm, for example, growth, financial leverage and size. These studies also attempt to determine the relationship between the above determinants towards firm performance. All in all, in this new era of globalization, the corporation is necessary to construct a plan to anticipate on risks.

1.2 Problem Statement

The firm annual report is a type of document that contains the organization information that's useful to the users of reporting and authorized to be produced annually. The purposes of annual reports are to provide the shareholders and others interested parties about the information on company performance and firmer activities to make better decision making. However, due to change in business models, the traditional financial statement cannot fulfil the needs of shareholders (Azlan, Abdul, and Bin, 2009). As a result, various companies advocate the use of non-financial part to include the necessary additional disclosure.

Among the additional disclosure added in the firm annual report, the subject relates the social and environmental obligation and the intellectual property occupancies the most. According to Linsley and Shrives (2005), the research to separate prospect of voluntary information disclosure has been started last 20 to 30 years, but the subject of risk and risk management only get the serious concern not long ago. This study is attempting at addressing this shortage of studies on risk disclosure reporting and firm performance in Malaysia listed companies.

According to Eugene (2015), around 96% of companies did not provide the complete risk information, and only 4% of corporate able to give concise and complete message about the way the corporate identified, evaluated and managed risk in the annual report. However, most of the listed issuers' clarity that the firm had assured a review of their internal control system and risk management, but they do not reveal the results based on the review. Furthermore, based on the PWC report released, Malaysia business has been achieved the basic requirement of reporting, but still had room to improve in covering integrated reporting, which is an evolution of corporate reporting based on the Integrated Reporting Framework (IRF) (PwC report, 2014). The IRF advises that company's annual report should include the following elements, for an instant, organizational overview and external environment, strategy and resource allocation, business model, opportunities and risks, governance, performance and future outlook. Based on the elements above, PWC's analysis indicates that risk disclose is the lowest scoring among the investigated corporations in Malaysia. In addition, all investigated firms consisted a risk management statement and internal control based the Bursa Malaysia listing requirement, however, only 27% reported their principal risks (PwC report, 2014). Based on the evidence above, it showed that Malaysia listed companies are still lack of the awareness in risk disclosure, the shortage of information in risk disclosure can misguide the investors making decision, and thus the company's performance affected.

Most studies about the risk disclosure and firm performance directed in developed countries, for example, United Kingdom (Linsley and Shrives, 2005;

Abraham and Cox, 2007), Netherland (Meijer, 2011), Italy (Beretta and Bozzolan, 2004), and Sweden (Pehrsson, 2011). Linsley and Shrives (2005) determined the risk disclosure in United Kingdom listed firms by collecting the risk information through company's annual report. The research mentioned that the more disclosure in risk can help the investors making a suitable judgment to firm performance. Besides, the researchers also suggest that the public listed companies should disclose more risk so that the investors can receive more transparency risk information and the good disclosure can lead to a better practice in corporate governance. Abraham and Cox (2007) also examine the relationship between the determinant for risk disclosure and corporate risk disclosure (CRD) in the annual report. The studies suggest that the information asymmetry can reduce the investors' confidence toward the firm and hence decline in firm performance. In addition, according to Meijer (2011), the studies supported that the level of risk disclosure can affect the company's performance in the long run. However, it is rare to find a research about risk disclosure and firm performance in developing countries, including Malaysia. This is a gap that this research aims to tackle.

1.2 Research Question

Based on the problem statement, this research builds for research questions, which are:

1. What is the relationship between the levels of risk disclosure and firm performance?
2. Is there any significant relationship between the growth of companies and firm performance?
3. Does leveraged affect the firm performance?
4. Is there any association between firm size and firm performance?

1.3 Research Objective

The main objective of this study is to determine whether the level of risk discloses practice in Malaysia had contributed to financial firm performance among listed companies in Malaysia, which is still an emerging market. There has been inadequate research in this area of study in Malaysia. The specific objectives of these studies are as follows:

1. To examine the significant relationship between the level of risk discloses and firm performance.
2. To investigate the significant relationship between the growth of companies and firm performance.
3. To examine the significant relationship whether the firm performance is affected by leveraged risk.
4. To investigate the significant relationship between the association between firm size and firm performance.